Report of the Office of Inspector General

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

To the Commissioner of the U.S. Customs Service:

We audited the U.S. Customs Service's (Customs) Balance Sheets as of September 30, 1999 and 1998, and the related Statements of Net Cost, Changes in Net Position, Budgetary Resources, Financing, and Custodial Activity for the years then ended. This report presents our unqualified opinion on these financial statements. Our audit disclosed the following material weaknesses relating to:

- Improving and integrating core financial systems (repeat condition, page 45), and

- Accelerating efforts to ensure timely restoration of mission-critical systems (repeat condition, page 47).

In addition, our audit disclosed 7 reportable conditions and 2 instances of reportable noncompliance with laws, regulations, and government-wide requirements. These findings are described in more detail in the following sections of this report.

MANAGEMENT'S RESPONSIBILITIES

Management is responsible for:

- Preparing the financial statements in conformity with generally accepted accounting principles.

- Preparing the Overview of Customs (as defined on page 44), required supplemental information, and other accompanying information.

- Establishing and maintaining internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the benefits and related costs of internal accounting policies and procedures.

- Complying with laws, regulations, and government-wide requirements applicable to Customs.

SCOPE OF AUDIT

We conducted our audit in accordance with *Government Auditing Standards*, as amended, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 98-08, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In planning and conducting our audit, we considered Customs' internal control over financial reporting and compliance with laws and regulations. Specifically, we obtained an understanding of the design of Customs' internal controls, determined whether these internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting and compliance with laws and regulations. Consequently, we do not provide an opinion on such controls.

In addition, with respect to internal controls related to performance measures reported in the Overview of Customs, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions and determined whether they had been placed in operation. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of Customs' compliance with (a) certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and (b) certain other laws and regulations specified in OMB Bulletin No. 98-08, as amended, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions and we did not test compliance with all laws, regulations, and government-wide requirements applicable to Customs. Providing an opinion on compliance with laws, regulations, and government-wide requirements was not an objective of our audit and, accordingly, we do not express such an opinion.

Under FFMIA, we are required to report whether Customs' financial management systems substantially comply with the following three general requirements: Federal Financial Management Systems Requirements, generally accepted accounting principles, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA included in Appendix D of OMB Bulletin No. 98-08, as amended.

We have read the information in the Overview of Customs and the other accompanying information and assessed whether such information, or the manner of its presentation, is materially inconsistent with the information, or the manner of its presentation, in the financial statements.

RESULTS OF AUDIT

OPINION ON THE FINANCIAL STATEMENTS

In our opinion, the financial statements present fairly, in all material respects, the assets, liabilities, and net position of Customs as of September 30, 1999 and 1998, and its net costs, changes in net position, budgetary resources, reconciliation of net costs to budgetary obligations, and custodial activity for the years then ended, in conformity with generally accepted accounting principles.

OTHER INFORMATION

In this report, we refer to the information in the following parts of the *U.S. Customs Service Fiscal Year 1999 Accountability Report* as the Overview of Customs:

- Messages from the Commissioner and Chief Financial Officer (pages 4 - 5).

- Customs' discussion of its mission, FY 1999 operational and financial results, Year 2000 issues, and Federal Manager's Financial Integrity Act (FMFIA) (pages 6 - 42).

Our audit was conducted for the purpose of expressing an opinion on Customs' fiscal year (FY) 1999 and 1998 financial statements referred to above. The information contained in the Overview of Customs and the other accompanying information is not a required part of the financial statements but is supplementary information required by OMB Bulletin No. 97-01, *Form and Content of Agency Financial Statements*, as amended. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on it. However, we compared this information for consistency with the financial statements and, based on this limited work, we identified no material inconsistencies.

INTERNAL CONTROL

Internal control is a process, effected by Customs' management and other personnel, designed to provide reasonable assurance that the following objectives are met:

- Reliability of financial reporting - transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with generally accepted accounting principles, and the safeguarding of assets against loss from unauthorized acquisition, use, or disposition;

- Compliance with applicable laws and regulations - transactions are executed in accordance with: (a) laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the financial statements, and (b) any other laws, regulations, and government-wide policies identified in OMB Bulletin No. 98-08, as amended; and

- Reliability of performance reporting - transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.

Because of limitations inherent in any internal control, errors or fraud may occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that internal control may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

As defined in OMB Bulletin No. 98-08, as amended, reportable conditions are matters coming to our attention that, in our judgment, should be communicated because they represent significant deficiencies in the design or operation of the internal control, that could adversely affect Customs' ability to meet the internal control objectives as defined above. Material weaknesses are reportable conditions in which the design or operation of the internal control does not reduce to a relatively low level the risk that errors, fraud, or noncompliance in amounts that would be material in relation to the financial statements being audited or material to a performance measure or aggregation of related performance measures may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We identified the following matters involving the internal control and its operation that we consider to be material weaknesses and other reportable conditions as defined above. Material weaknesses and other reportable conditions that we identified in our *Report on the U.S. Customs Service's Fiscal Years 1998 Financial Statements***,** (OIG-99-050, issued March 17, 1999), and that continued to exist during FY 1999, are identified as "Repeat Condition."

We considered the material weaknesses described below in forming our opinion on whether Customs' financial statements as of September 30, 1999 and 1998, and for the years then ended are presented fairly, in all material respects, in conformity with generally accepted accounting principles, and these weaknesses do not affect our opinion expressed above.

MATERIAL WEAKNESSES

1. Core Financial Systems Need To Be Improved and Integrated (Repeat Condition)

Customs' core financial systems did not provide certain critical financial information necessary for managing operations, such as a "customer-based" subsidiary ledger for non-entity accounts receivable. The financial systems also did not capture all transactions as they occurred during the year, did not record all transactions properly, and were not fully integrated. As a result, extensive manual procedures and analyses were required to process certain routine transactions and to prepare financial statements at fiscal year-end. Additionally, the systems did not always provide for essential controls with respect to override capabilities and changes to system data.

Weaknesses in the core financial systems are discussed below:

- <u>Automated Commercial System (ACS) Accounts Receivable Subsidiary Ledger</u> Customs' accounts receivable subsidiary ledger system in ACS was "transaction-based" rather than "customer-based." During the year, ACS could not provide summary information of the total unpaid assessments for duties, taxes, and fees by individual importer. Also, ACS did not generate periodic management information on outstanding receivables, the age of the receivables, or other data necessary for managers to effectively monitor collection activity by customer. Additionally, ACS did not interface with Customs' general ledger system to record all receivables throughout the year. As a result, Customs had to determine the $921 million recorded balance for

Non-Entity Accounts Receivable, Net as of September 30, 1999, after the fiscal year-end, through the use of ad hoc reports and manual procedures.

- Recording Currency Transactions In Seized Asset and Case Tracking System (SEACATS) Although Customs continued to make significant improvements in processing seized and forfeited property in SEACATS, the system did not maintain accurate and sufficient currency data that could be relied upon for financial reporting purposes without substantial manual reconciliation. Consequently, SEACATS could not produce the analysis of changes in seized currency for the seized and forfeited property disclosure.

- Cost Accounting Customs based reimbursable charges for certain inspection positions and other reimbursable services on budget estimates in FY 1999. Customs' Cost Management Information System (CMIS) tracks costs based on estimates provided by field offices and an inspectors overtime scheduling system. However, the source data input into CMIS needs further refinement to enable Customs to evaluate the accuracy of the budget estimates. More reliable information will ensure that the estimated charges approximate actual costs.

  Additionally, Customs currently produces cost management information only at year-end. Cost management information should be produced on a regular basis throughout the fiscal year to provide management with relevant and timely information upon which to base operational decisions.

- Recording Certain Transactions In ACS Accurate information was not always maintained in ACS for the total duty paid on import entries of goods assembled abroad with domestic components. Importers are allowed to deduct the cost of domestic components from the dutiable value of manufactured imported goods. Importers are also permitted to file estimated cost data in support of the dutiable value of the goods when entered, and furnish actual cost data at a later date -- referred to as a "cost submission." Our testing revealed that, based on subsequently furnished cost submissions, Customs recorded the total amount refunded, or additional payment received, against only one or a small number of related import entries rather than against each actual import entry. Thus, ACS did not always reflect the correct liquidated duty amount on import entries related to cost submissions. Accordingly, a subsequent drawback claim for an excessive amount may not be detected in a timely manner. Conversely, ACS may reject a valid drawback claim.

  Customs implemented the ACS reconciliation prototype on October 1, 1998. Among other things, the reconciliation process is intended to permit the liquidation of entries specifically identified by claimants. However, reconciliation entries were not liquidated until FY 2000. We will evaluate the ACS reconciliation prototype during our audit of Customs FY 2000 financial statements.

- Recording Certain Transactions In The General Ledger System Certain transactions were not properly recorded in the general ledger system as they occurred. Specifically, Customs programmed its general ledger system to record the use of appropriations for all transactions. As a result, during the year Customs accountants analyzed the various financing source and expenditure accounts and then manually reversed appropriations used and related net position accounts used for the special funds. These adjustments were necessary because Customs incorrectly recorded these transactions as appropriations used.

  Additionally, Customs was unable to record a liability in the general ledger system upon receipt of goods and services. Accordingly, accounts payable were not established and related obligations were not liquidated in the system in a timely manner. As a result, manual procedures had to be used subsequent to the end of the fiscal year to determine $86 million of the $139 million recorded balances for intra-governmental and other accounts payable as of September 30, 1999.

- ACS Override Capabilities Certain ACS controls can be overridden without supervisory approval. For example, when an import specialist attempts to liquidate an import entry in ACS, the system displays a warning message, if appropriate, indicating that a drawback claim had been filed against the import entry. The purpose of this control is to ensure that both a refund and drawback are not paid on the same goods. However, import specialists could, without supervisory review, override the warning message and process a refund without investigating pending drawback claims. We also determined that import specialists could override system edits designed to detect refunds exceeding the total duty, tax, and fees paid on an import entry. ACS would require reprogramming to generate override reports for supervisory review.

- Systems Integration Customs' aircraft parts inventory system did not interface with the general ledger system to record the assets and related financing sources for aircraft parts inventory when purchased and costs when parts are used in operations. As a result, the accounting records did not accurately reflect the values of inventory balances or activity at any point in time throughout the year. During FY 1999, Customs recorded inventory additions in the general ledger when invoices were paid and recorded inventory consumption in the general ledger on a quarterly basis.

  Additionally, Customs' Special Agent-in-Charge (SAIC) offices maintain separate accounting records for each covert operation. Because these accounting records were not integrated with the general ledger system, the financial results of covert operations are manually summarized and recorded in the general ledger on a monthly basis.

  A long-term information strategy plan has been developed to serve as a guide for integrating financial systems. Customs is proceeding with the Quality Planning for Asset Management project which includes integrating various processes including budget, acquisition, and accounts payable.

Recommendations

We reaffirm our recommendations from previous financial statement audits that Customs (a) ensure that any new systems initiatives include a "customer-based" accounts receivable subsidiary ledger that interfaces with the general ledger system, (b) implement standard procedures to record refunds or payments against the individual import entries associated with cost submissions, (c) develop a comprehensive plan to identify the modifications necessary to the general ledger system so that all financial transactions are captured as they occur, and (d) implement standard procedures to provide for appropriate supervisory review and authorization of critical ACS warning messages and other edit checks that can be overridden.

We are making the following new recommendations as a result of our fiscal year 1999 financial statement audit:

The Commissioner of Customs should ensure that the source data input into CMIS is refined to allow Customs to evaluate the accuracy of the budget estimates related to reimbursable charges for certain inspection positions and other reimbursable services.

2. Efforts To Ensure The Timely Restoration Of Mission-Critical Systems Need To Be Accelerated (Repeat Condition)

Several significant deficiencies were identified in Customs’ ability to provide for timely restoration of mission-critical systems that could impair Customs’ ability to respond effectively to a disruption in operations. Without proper attention to service continuity, Customs risks losing the capability to process, retrieve, and protect information maintained electronically, thus significantly affecting its ability to accomplish its mission. Portions of this finding include repeat conditions relating to disaster recovery capabilities. Due to the sensitive nature of this matter, we are providing further details in a separate report with limited distribution.

REPORTABLE CONDITIONS

3. Drawback Controls Need To Be Strengthened (Repeat Condition)

Customs’ controls over drawback continued to need improvement during FY 1999. Drawback payments are refunds of duties and taxes paid on imported goods that are subsequently exported or destroyed. Existing procedures over drawback should be strengthened and enforced to prevent duplicate, excessive, or otherwise improper drawback payments. Such procedures are essential because once drawback payments are made and the related claim is liquidated, Customs does not have legal authority to demand a return of overpaid drawback, unless fraud is determined.

Customs developed and formalized a policy on drawback processing in September 1997. However, as we noted in our prior year report, drawback specialists still did not consistently annotate, on the original import entry or invoice at the line item level, the quantity for which drawback was claimed. Furthermore, we noted that documentation supporting the drawback specialists’ basis for approval was not always complete. For example, we found that (a) drawback specialists did not consistently obtain proofs of export (shipping documents) from sampled Export Summary Procedure (ESP)[1] claimants before liquidating claims, (b) required information (e.g., carrier name, bill of lading numbers, etc.) for the exported merchandise upon which drawback was being claimed was not always provided by nor requested from ESP claimants, and (c) supervisory reviews and approval of claim payments were not consistently documented.

The September 1997 policy does not require drawback specialists to (a) review all prior claims against a selected import entry to determine whether, in the aggregate, excessive amounts had been claimed against import entries and, if applicable, import entry line items or invoices, or (b) statistically sample proofs of export from ESP claimants before liquidating drawback claims. Additionally, supervisory review policies were not consistent between drawback offices, resulting in the use of different documentation methods and thresholds above which review was required.

It should be noted that, as a compensating control, Customs' financial advisors statistically sample drawback payments and liquidations to determine whether claims (a) are properly prepared and supported and (b) do not exceed the duty and tax paid and the quantity available for drawback on related import entries and, if applicable, import entry line items when aggregated with previous claims filed against FY 1995 through FY 1999 entries. Customs plans to continue carrying out this compensating control into the future.

We reviewed Customs' methodology for this compensating control procedure, sampled the claims reviewed by Customs, and performed other drawback testing procedures. Based on our tests, we concurred with Customs' methodology and results that there were no significant duplicate, excessive, or otherwise improper drawback disbursements, on a national level, made during FY 1999. However, Customs' testing revealed, and we confirmed, that drawback payments made by the Boston Customs Management Center (CMC) lacked appropriate review, approval, and adequate supporting documentation. Specifically, the testing identified $145,468 in overpayments out of a sample of $2,029,260. In addition, the tests revealed 39 processing errors out of a sample of 47 items. These errors related to incorrect classification of entry type, lack of documented supervisory review, incomplete required documentation, and overpayments. Furthermore, supporting documentation for the sample selected was not easily accessible. As a result, an excessive amount of time and resources was required to identify and provide appropriate documentation for testing. Prior to the end of our fieldwork, Customs developed a draft corrective action plan effective in FY 2000 to address these findings at the Boston CMC.

Recommendations

We reaffirm the recommendations from our previous financial statement audit that Customs needs to (a) implement effective controls over drawback claims as part of any new systems initiatives, (b) consistently adhere to the formal policy on drawback processing, issued in September 1997**,** (c) amend the formal policy to specifically require, in a consistent manner, drawback specialists to (1) review all prior claims against a selected import entry to determine whether, in the aggregate, excessive amounts had been claimed against import entries and, if applicable, the import entry line item or invoice; (2) statistically sample proofs of export from ESP claimants before liquidating drawback claims; and (3) establish standard guidelines/thresholds for evidence of supervisory review.

We are making the following new recommendations as a result of our fiscal year 1999 financial statement audit:

The Commissioner of Customs should ensure that:

1. The Boston CMC processes drawback disbursements in accordance with the drawback policy.

2. The Boston CMC rearranges its current filing system to enable reasonable access and retrieval of documentation.

[1] Claimants may file under Export Summary Procedure and provide a representation that the goods, for which drawback was claimed, were exported -- as opposed to submitting shipping documents and other detailed support. ESP claimants are required to provide Customs with proof of export upon request.

4. Compliance Measurement Programs Need To Be Comprehensively Implemented To Identify The Revenue Gap And Assess Trade Law Compliance (Repeat Condition)

During fiscal year 1999, Customs continued its statistically-based examination programs, referred to as compliance measurement programs (CMP). CMPs are designed to quantify the revenue gap and assess trade law compliance. Among Customs' most critical CMPs are: (a) the consumption entry CMP, which projects revenue over- and under-collection, (b) the carrier manifest CMP, which measures the accuracy of carrier reporting of cargo arriving in the United States, (c) the bonded warehouse CMP, which measures compliance by bonded warehouse operators, and (d) the in-bond CMP, which measuresthe accuracy of cargo information for merchandise allowed to move within the United States without classification or appraisement.

During FY 1999, based on examination results from its consumption entry CMP, Customs projected $383 million in revenue under-collections and $131 million in revenue over-collections. Because these amounts are statistical projections and, as a result, there are no known non-compliant importers for which a legally enforceable claim or refund can be assessed, an accounts receivable or accounts payable cannot be recognized as they do not meet the criteria under generally accepted accounting principles.

We noted the following weaknesses concerning the compliance measurement program: (a) Customs did not subject all entered cargo to the consumption entry CMP, (b) Customs did not complete the FY 1998 bonded warehouse CMPs until FY 2000, (c) Customs has not conducted CMP examinations on FY 1999 bonded warehouse entries, (d) Customs has not formulated a CMP for Foreign Trade Zones (FTZ), and (e) Customs has not conducted the air carrier manifest CMP since the end of FY 1998. Although Customs implemented the in-bond CMP (Tinman), Customs was still unable to ensure that goods moving in-bond were not diverted into the United States commerce without proper classification and appraisement. Specific weaknesses in the CMPs are described below.

In previous financial statement audits, we determined that the consumption entry CMP did not subject cargo valued by importers at under $2,001, the formal entry limit, to cargo examination selection. This presented a risk that importers could knowingly circumvent Customs controls, thereby avoiding the proper payment of duties, taxes and fees. To evaluate this risk, Customs conducted a study of cargo entry lines with electronically transmitted values under $2,001, from June 9, 1999 to August 24, 1999, to determine whether importers understated entry values to avoid physical examination. Preliminary results indicated that a) although not required by the study, over 280 physical examinations of merchandise were performed for the 1,186 line items sampled without error, and b) only one, or .08 percent, of the lines sampled was incorrectly valued under $2,001. Customs plans to conduct further analysis of the results of this study. We will evaluate Customs' final report on this study during our audit of Customs FY 2000 financial statements.

Our audit also identified that Customs did not track merchandise quantities in ACS moving to and from bonded warehouses and FTZs. Moreover, Customs ports did not consistently perform spot checks as required to ensure that the proprietors of these facilities maintained accurate inventory records and complied with other Customs requirements. These weaknesses may result in goods being diverted into the United States commerce from bonded warehouses and FTZs without Customs' knowledge and proper assessment of duties, taxes, and fees. Our prior year audit included the recommendation that Customs develop and implement a CMP for FTZs; however Customs has stated that this is not feasible since the Application for Foreign-Trade-Zone Admission and/or Status Designation (Customs Form 214) is not automated. In our report *United States Customs Service Oversight of Foreign Trade Zones Activity* (OIG–00-015, issued December 22, 1999), we recommended that Customs assess its ability to develop automated CF-214 reporting. Customs responded that it was in the early stages of developing an automated CF-214. This would enable Customs to then develop and implement a CMP for FTZs.

In addition, Customs has not conducted the air carrier manifest CMP since FY 1998. Accordingly, Customs lacked sufficient assurance as to the reliability of cargo information reported on manifest documentation. Customs developed a CMP plan that was to be implemented at the beginning of FY 1999. However, implementation was delayed pending agreement on unresolved labor issues. As a result, Customs management had to further refine the carrier manifest CMP. It should be noted that Customs resumed the sea carrier manifest CMP on March 1, 1999.

Customs implemented the Tinman CMP in September 1998 to mitigate the weaknesses noted in our prior year financial statement audits. Although improvements have been made, we identified the following weaknesses relating to the Tinman CMP:

- The Tinman CMP provides only for a description and quantity verification of in-bond shipments. Improvements are needed to provide Customs assurance that imported merchandise transactions were not diverted into the commerce of the United States without assessment of duties, taxes, and fees.

- The Tinman CMP does not require random selection of in-bond shipments for physical examination. Although the date and time of the examinations are randomly selected, the actual in-bond shipments are selected judgmentally; thus, creating a biased sample. We also noted that the inspectors, at the ports we visited, only selected manually-filed in-bond shipments for physical examination, thereby neglecting the universe of electronically-filed in-bond shipments. Consequently, the results of the examinations performed may not provide Customs with reasonable assurance on the controls over in-bond shipments.

- The ACS INRA screen, which reports the results of physical examinations, lacks a remarks section for non-discrepant shipments. Such an enhancement would provide a means for communicating additional or clarifying information that could facilitate post audit reviews.

- During FY 1999, Customs performed 609 physical examinations and thousands of 60- and 90-day post-audit reviews. However, Customs has not analyzed the results of the FY 1999 examinations nor the post-audit reviews. As a result, Customs is unable to determine whether the number of physical examinations was sufficient or if its policy to systematically close all open in-bond transactions after 120 days is appropriate.

CMPs for these areas are essential to ensure accountability over imported goods processed within or entered into the United States commerce, or held by, and withdrawn from bonded warehouses and FTZs. Until Customs fully implements a comprehensive set of CMPs, it lacks the information needed to adequately focus its trade compliance efforts.

Recommendations

We reaffirm our recommendation from previous financial statement audits that Customs implement objective programs to measure compliance for all areas of trade and user fee laws that have significant revenue gap implications. We recommend that the Commissioner of Customs ensure that: (a) bonded warehouse CMPs are conducted for FY 1999, the results are fully analyzed, and appropriate actions taken, (b) once the CF-214s are automated, a CMP is formulated and conducted for FTZs, and (c) air carrier manifest CMPs are resumed.

We are making the following new recommendations as a result of our fiscal year 1999 financial statement audit:

The Commissioner of Customs should ensure that:

1. Customs completes its study of cargo valued by importers at under $2,001 that was conducted during FY 1999.

2. Customs finalizes and implements its draft policy on the Foreign-Trade Zone Compliance Check Program.

3. Improvements are made to the Tinman CMP post-audit review process to verify the appropriate resolution of in-bond transactions, e.g., review of entry and export documents.

4. Procedures for the Tinman CMP are implemented to provide a random sample of shipments selected for examination.

5. AMS is enhanced to allow for the entry of remarks relating to non-discrepant Tinman examinations and require all inspectors to report any details that would facilitate post audit reviews.

6. The results of the Tinman CMP are analyzed to include the determination of the sufficiency of the number of physical examinations performed during the fiscal year.

7. Once the draft procedures for post-audit reviews are implemented and have been in place for a reasonable period of time, the results of the post-audit reviews are summarized and analyzed to determine whether the number of reviews is sufficient and the propriety of the 120-day in-bond closure policy.

5. Controls Over Bills Of Lading And In-Bond Shipments Need To Be Strengthened (Repeat Condition)

Controls over open bills of lading and open in-bond shipments continued to need improvement during fiscal year 1999. A bill of lading remains open in ACS until all imported merchandise on the bill of lading is recorded as either (a) released into the commerce of the United States; (b) authorized to move in-bond, to a bonded warehouse, or to a foreign trade zone (FTZ); or (c) exported. In-bond shipments remained open in ACS until the shipment is either recorded as having arrived at the intended port of destination or exported. Because open in-bond transactions could represent merchandise that was diverted into the United States commerce without assessment of duties, taxes and fees, controls over in-bond shipments should be strengthened to ensure that revenue is not lost.

Notwithstanding the advent of an in-bond CMP, or Tinman, Customs is still unable to ensure that goods moving in-bond were not substituted or diverted into the United States commerce without proper assessment. As a compensating control, Customs statistically sampled the open in-bond transactions to determine whether they represented merchandise that should have been assessed but was not. However, as of the end of our fieldwork, Customs had not been able to obtain documentation supporting approximately 10% of the transactions in its sample. Without this documentation, Customs was not able to determine whether these open transactions represented a potential loss of revenue to the United States government. Subsequently, through an intensive effort, Customs was able to obtain supporting documentation for all but 18 (4%) of the items in its sample.

In addition, as noted in previous audit reports, our tests revealed that ACS could not match open transactions to events that would enable them to appropriately close. Customs' tests identified, and we confirmed that, for a significant number of the open transactions, this was caused by errors relating to the input of merchandise quantities and bills of lading by trade participants and Customs personnel. Due to a lack of appropriate system edits, these transactions could not be appropriately matched and closed in the system. Additionally, we noted that carriers and importers are still permitted to record imported merchandise in different units of measure (e.g., pounds vs. kilograms, pallets vs. boxes, etc.) on Customs documents. These input errors and inconsistencies in units of measure prevented the timely closure of open merchandise transactions.

Recommendations

We reaffirm the recommendations from our previous financial statement audits that Customs correct operational and ACS system weaknesses that make it difficult to ensure the appropriate resolution of open merchandise transactions.

We are making the following new recommendation as a result of our fiscal year 1999 financial statement audit:

The Commissioner of Customs should ensure that Customs reviews its FY 1999 testing of open in-bond transactions to determine the reason that supporting documentation for certain transactions in its sample could not be provided either in a timely manner or at all, and that appropriate policies and procedures be implemented to correct the problem.

6. Accountability Controls Over Seized Property Inventory Need Improvement

Nine narcotic seizure line items could not be located or accounted for at the Otay Mesa seized property storage vault located in San Diego, CA, when Customs performed its FY 1999 seized property inventory in September 1999. Narcotic and weapon evidence must be accounted for completely, accurately, and timely to ensure that such evidence is not compromised for federal prosecution purposes and is protected against the risk of theft, misuse, or loss.

According to personnel from Customs' Fines, Penalties, & Forfeitures (FP&F) Branch, six of the nine seizure line items were identified as missing during the FY 1998 inventory; however, Internal Affairs (IA) was not notified.

Customs' policy requires that after the completion of annual physical inventory verifications, IA is to be notified of all missing property and any narcotics with a weight discrepancy greater than the pre-established tolerances. Upon completion of the FY 1998 inventory, IA was only alerted to the identified weight discrepancies, but not the six missing seizure line items. The remaining three missing seizure line items were identified during the FY 1999 physical inventory verification. IA was notified of the nine missing seizure line items at the conclusion of the FY 1999 inventory.

Customs' FP&F personnel believe that the seizures may have been destroyed and the documentation lost through an administrative error. As a result, a complete search of destruction records for the last 3 years is being performed. However, the chain of custody documentation for all of the missing seizures indicates that the seizures should be located in the storage vault.

The resolution of these cases is pending an ongoing investigation by IA. As it is Customs policy not to disclose any information related to an ongoing investigation, we were not able to obtain information about the status of the nine missing seizures.

Recommendations

The Commissioner of Customs should ensure that:

1. The investigation into the missing seizures determines the reason that the six seizures identified as missing during the FY 1998 annual physical inventory verification were not reported to IA.

2. The current investigation is completed expeditiously, and that appropriate action is taken as a result of the investigative findings.

7. Entity-Wide Security Program Planning And Management Needs To Be Improved

Customs did not establish a framework to assess risk, develop and implement effective security procedures, or monitor the effectiveness of these procedures, on a continual basis. Customs did not assess the risk to its computer resources at its Newington Data Center as well as at other remote computer locations. Customs did not fully comply with its policy regarding the appointment of computer security officers (CSO), nor the development and administration of formal training for CSOs and network security administrators (NSA). Additionally, Customs had a defined capability for identifying incidents as suggested by the National Institute of Standards and Technology; however, the policy was not finalized during FY 1999, nor were the procedures for implementing the policy developed. As of the date of this report, Customs was in the process of completing "certification and accreditation" (C&A) and re-accreditation of its systems.

Customs did not perform formal risk assessments on its Newington Data Center configurations nor on any of the 20 CMCs or remote computer locations throughout the United States. Also, Customs did not fully implement the requirement for CSOs according to its Automated Information Systems Security Policy. We also determined that CSOs are not being trained on a consistent basis. Customs' Office of Information Technology (OIT) training office did not develop or administer formal training classes for its CSOs or NSAs.

We also noted that Customs had not fully documented an incident response capability. The Computer Security Incident Response Capability (CSIRC) policy was in draft mode and therefore had not been formally approved and implemented. Also, the procedures referenced in the CSIRC Operations Handbook were not developed. This Operations Handbook will provide the day to day operating procedures to be followed in implementing the policies contained in the CSIRC policy. During FY 1999, Customs personnel relied on informal and undocumented procedures.

As of the date of this report, Customs was in the process of completing a C&A of its new systems and applications and the re-accreditation of its existing (legacy) systems and applications. However, guidance regarding the requirements for completing the C&As was not broadly understood and accepted, and we found compliance with the security requirements to be incomplete. Without a defined set of System Development Life Cycle (SDLC) - C&A documents, the true risks and vulnerabilities of the legacy mission critical software applications will not be identified for the OIT system owners, process owners, or CSOs to make a meaningful review of the risk of continued operations. We estimate that many of these mission critical legacy software applications will be in operation for at least another 5 years.

Recommendations

The Commissioner of Customs should ensure that:

1. The risk assessments task project be given a high priority and that adequate resources are made available in FY 2000 to conduct a formal risk assessment for the Newington Data Center computer site configurations, the 20 CMCs, and the other mission critical remote data entry locations.

2. Customs fully implements the CSO position to cover all major areas of information systems security.

3. Customs' OIT training management assigns a high priority to the following:

    a. Developing security and network individual development plans (IDP) for all CSOs and NSAs in computer and network security subject areas.
    b. Providing appropriate training for CSOs, NSAs, and employees responsible for contingency planning (after the IDP development phase).
    c. Updating the computer based training course currently used for both new employees' awareness and annual refresher training to reflect changes in Customs' security policy and rules of behavior contained in its new and revised security policy.
    d. Revising and updating the new employees Security Handbook to reflect the new policies and rules of behavior.

4. Customs' management completes the review and approval of the CSIRC policy.

5. Customs' management develops and implements the CSIRC Operations Handbook.

6. Customs completes the C&A of its new systems and applications and the re-accreditation of its existing (legacy) systems and applications.

7. The guidance in the Automated Information Systems Security Policy Handbook is expanded to address on-going maintenance (life support) of legacy security certification and accreditation requirements and ensure integration with the SDLC handbook.

8. Logical Access Controls Need To Be Improved (Repeat Condition)

We identified several deficiencies in Customs' logical access controls over its data files, application programs, and computer-related facilities and equipment. Such controls protect against unauthorized modification, disclosure, loss, or impairment. We determined that system programmers had been granted inappropriate update access to production data through its CA-Top Secret profiles. Due to the sensitive nature of this matter, we are providing further details in a separate report with limited distribution.

9. Application Software Development And Change Controls Need To Be Fully Implemented For Legacy Applications and/or Systems (Repeat Condition)

During our audit, we noted that Customs made progress in instituting policies, procedures, and techniques to ensure that all new programs and program modifications are properly authorized, tested, and approved, and that access to and distribution of programs are carefully controlled. While progress was observed in the area of application controls, Customs controls over system software and infrastructure changes were not fully implemented. The policies and procedures established in Customs' SDLC standards and guidance were not applied to the total inventory of systems software applications. Specifically, policies and procedures to identify, select, install, and modify system software on the OS 390 system have not been documented. Formalized policies and procedures should be applied to mainframe computers, networks, telecommunications software, all software tools, system software utilities, data base management system software and all commercial system software packages that are included in the inventory maintained by Customs' Systems Engineering Branch and Systems Operations Branch.

Also, from our follow-up on previous audit recommendations, we noted that ACS documentation was still inadequate. However, in FY 1999 Customs made progress on a Master Schedule to complete ACS documentation by the second quarter of FY 2001.

Recommendations

We reaffirm our recommendations from previous financial statement audits that Customs (a) update ACS systems documentation to an acceptable level so as to allow users to adequately operate and maintain the system, (b) implement procedures to ensure that appropriate documentation is maintained for all major applications and general support systems, and (c) implement procedures to provide for appropriate end-user training and communication of systems changes.

We are making the following new recommendation as a result of our FY 1999 financial statement audit:

The Commissioner of Customs should ensure that the OIT establishes and implements a strong configuration management policy that covers all aspects of Customs automated resources, specifically ensuring the application of and adherence to SDLC policies and procedures for infrastructure systems.

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Our consideration of the internal control would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses.

COMPLIANCE WITH LAWS AND REGULATIONS

The results of our tests of compliance with laws, regulations, and other government-wide requirements, exclusive of FFMIA, disclosed one instance of noncompliance with the following laws and regulations that are required to be reported under *Government Auditing Standards*, as amended, and OMB Bulletin No. 98-08, as amended. This instance is described below:

The Chief Financial Officers Act of 1990 requires Customs to conduct a biennial review to determine the appropriateness of fees and other charges imposed by it for services and things of value it provides, and to make recommendations on revising those charges to reflect costs incurred by it in providing those services and things of value. For FY 1999, Customs completed the first of a two phase process that is intended to: (1) review the appropriateness of the fees, and (2) if necessary, to revise those fees to reflect costs incurred in providing the related services. Customs completed its determination of the propriety of the fees, however, it was unable to revise certain fees to reflect costs incurred during FY 1999. Therefore, Customs is not in full compliance with the CFO Act. Customs plans to initiate actions to recommend changes to the fees or to make the necessary revisions to these fees in FY 2000. See the related cost accounting weaknesses discussed on page 46 in the Internal Control section of this report.

In addition, the Consolidated Omnibus Budget Reconciliation Act (COBRA) of 1985 requires a biennial review and reporting of its COBRA charges every even numbered fiscal year. We reported in last year's audit that Customs had not complied with this requirement. During FY 1999, Customs reviewed the appropriateness of COBRA fees as part of the biennial review described above, however, it did not make recommendations for changes to those fees.

Except for the instance described above, the results of our tests of compliance disclosed no other instances of noncompliance with other laws, regulations, and government-wide requirements, exclusive of FFMIA, that are required to be reported under *Government Auditing Standards*, as amended, or OMB Bulletin No. 98-08, as amended.

The results of our tests disclosed instances where Customs' financial management systems did not substantially comply with the financial management systems requirements referred to in FFMIA. The instances summarized below are discussed in more detail along with Customs' planned remedial actions and time frames to implement such actions in the section titled “Federal Managers’ Financial Integrity Act (FMFIA) Summary” on pages 40-42 of the *U.S. Customs Service Fiscal Year 1999 Accountability Report*:

- Customs’ core financial systems do not provide complete and accurate information for financial reporting and preparation of audited financial statements.

- Several weaknesses were identified in Customs’ electronic data processing general controls in the areas of: (1) timely restoration of its mission-critical systems; (2) logical access controls over its data files, application programs, and computer-related facilities and equipment; (3) application software development and program modifications; and (4) entity-wide security program.

This report is intended solely for the information and use of the management of Customs, the U.S. Department of the Treasury, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is available to the public as a matter of public record.

William H. Pugh

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January 21, 2000